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In the Supreme Court of the United States

OCTOBER TERM, 1975

HOME SAVINGS AND LOAN ASSOCIATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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The sole question presented by the petition in this federal income tax case is whether, when petitioner purchased for cash all of the so-called guarantee stock (representing the capital interest) of two other California savings and loan associations and liquidated them into itself under the state merger statute, the Commissioner of Internal Revenue correctly restored to income of the liquidated associations the

portions of their bad debt reserves previously deducted from gross income, and also attributed to them income earned but not collected prior to liquidation.

The pertinent facts are as follows: On January 11, 1956, petitioner, a California savings and loan association, purchased for $8,031,107 cash the 20,000 outstanding shares of guarantee stock of Pasadena Savings and Loan Association ("Pasadena"). Two months later, on March 12, 1956, with the approval of the California Savings and Loan Commissioner, petitioner liquidated the acquired association into itself under the state merger statute and continued its business without interruption on the same premises Pasadena had previously occupied. At that time, Pasadena had outstanding not only the 20,000 shares of guarantee stock purchased by petitioner, carried on Pasadena's books at $10 per share, or $200,000, but also 650,252 withdrawable shares representing deposits of $65,025,252.58. As a result of the merger, Pasadena's guarantee stock was cancelled, and 97.2 percent of the withdrawable shares of Pasadena were converted into withdrawable shares of petitioner, in the same amount[1] (Pet. App. A 5-10; Pet. App. B 25-26).

In essentially identical fashion, petitioner, between May 23 and July 9, 1956, purchased the 1,000 outstanding shares of guarantee stock of Savings and Loan Association of Anaheim ("Anaheim") for

[1] The remaining 2.8 percent of the withdrawable shares of Pasadena were presumably withdrawn.

$2,260,729 in cash. The California Savings and Loan Commissioner approved the liquidation of Anaheim and its merger into petitioner. Petitioner continued Anaheim's business without interruption on the premises previously occupied by Anaheim. At that time, Anaheim had outstanding not only the 1,000 shares of guarantee stock purchased by petitioner, carried on Anaheim's books at $100 per share, or $100,000, but also 177,365 investment certificates representing deposits of $17,736,544. As a result of the merger, Anaheim's guarantee stock was cancelled, and the investment certificates were converted into withdrawable shares of petitioner in the same amount (Pet. App. A 5-10; Pet. App. B 26-27).

On its books, petitioner treated these two transactions as acquisitions of the assets of Pasadena and Anaheim for the cash paid for their guarantee stock, and the assumption of their liabilities, including the amount of Pasadena's withdrawable shares and of Anaheim's investment certificates (Pet. App. A 10-12).

On audit, the Commissioner of Internal Revenue determined that Pasadena was required to include in income $5,281,452.87 for its last taxable period prior to its liquidation. That amount represented its bad debt reserve previously deducted from taxable income during its taxable years beginning with 1952 until liquidation. The Commissioner also required its inclusion of $436,121.63 in income, which represented income earned but not collected prior to liquidation. On the same basis, Anaheim was required to take into income for the period prior to its liquidation,

$1,087,563.39 and $88,089.88, respectively. The resulting deficiencies were assessed against petitioner as transferee of the liquidated associations (Pet. App. A 1-2, 12-13).

In this suit for refund, petitioner asserted that the transactions by which it acquired and liquidated Pasadena and Anaheim were corporate reorganizations within Section 368(a)(1)(A) of the Internal Revenue Code of 1954, so that it was entitled to carry forward the bad debt reserves of Pasadena and Anaheim in accordance with Section 381(a) and (c)(4) of the Code and Treasury Regulations, Section 1.381 (c)(4)-1(b)(1), Ex. (1). The district court upheld petitioner's position (Pet. App. B 22-41). The court of appeals reversed, holding that the transactions whereby petitioner acquired Pasadena and Anaheim were purchases and were not reorganizations within Section 368 of the Code because they lacked the requisite "continuity of interest" (Pet. App. A 1-21).

1. The court of appeals correctly recognized that resolution of the issue before it required an analysis of the interests in California savings and loan associations. Pursuant to such an analysis (Pet. App. A 6-7, 13-20), it concluded (Pet. App. A 6) that under the California statutes the term "stock" embraced only the so-called "guarantee stock," the proceeds of which were required to be 'set apart' and 'maintained as a fixed and permanent capital of the association," so that (Pet. App. A 16) the guarantee stock was the "true equity interest of these associations." The so-called withdrawable shares of

Pasadena (though having the limited voting power to elect a minority of the board of directors) and, even more clearly, the investment certificates of Anaheim, represented only creditors' interests similar to savings deposits in banks, and not equity interests (Pet. App. A 13-20).

In so holding, the court of appeals drew upon not only the relevant California statutes but also a decision of the California Supreme Court (*In re Pacific Coast Building—Loan Assn.*, 15 Cal. 2d 134, 99 P. 2d 251) holding that the owners of withdrawable shares were creditors of the association, and the relevant provisions of the Internal Revenue Code treating (Sections 591 and 116(c)(1)) so-called dividends on withdrawable shares as interest paid and assimilating (Section 593(b)(1)(B)) withdrawable accounts with deposits. There is no basis for further review of the court of appeals' determination under California law, particularly when it is supported by related federal statutes. See *Propper* v. *Clark*, 337 U.S. 472, 486-489.

2. Given the court of appeals' analysis of the relevant California law, the federal tax results follow upon either of two distinct, though related, grounds.

First. This Court decided long ago, in landmark decisions, that a purchase for money, or for obligations to pay money, does not give rise to a reorganization within the provisions that now appear as Section 368 of the 1954 Code because the required "continuity of interest" in the acquiring corporation by the stockholders of the acquired corporation is lack-

ing. *Pinellas Ice & Cold Storage Co.* v. *Commissioner*, 287 U.S. 462; *LeTulle* v. *Scofield*, 308 U.S. 415. See *Helvering* v. *Minnesota Tea Co.*, 296 U.S. 378, 384-385. These fundamental decisions are equally applicable to deny reorganization treatment to corporate acquisitions where state merger statutes are employed but the stockholders of the acquired corporation receive no continuing proprietary interest in the acquiring corporation. *Roebling* v. *Commissioner*, 143 F.2d 810 (C.A. 3); *Southwest Natural Gas Co.* v. *Commissioner*, 189 F.2d 332 (C.A. 5), certiorari denied, 342 U.S. 860. See Bittker and Eustice, *Federal Income Taxation of Corporations and Shareholders*, para. 14.11 (3d ed. 1971). Thus, in this case, where the stockholders of Pasadena and of Anaheim received only cash for their stock, and no continuing interest in petitioner, there was no reorganization and no basis for application of the carry-forward provision of Section 381.

Second. Since petitioner acquired all of the stock of Pasadena and of Anaheim within one year and liquidated them within two years, Section 334(b)(2) of the Code provides that the basis of their assets in the hands of petitioner should be the cost of the stock, plus the liabilities assumed. This is true even though a state merger statute was employed as the means of liquidation, and even if the merger might otherwise have constituted a reorganization. *Kansas Sand and Concrete, Inc.* v. *Commissioner*, 462 F.2d 805 (C.A. 10). Since Section 334(b)(2) governed the liquidation, Section 381(a)(1) is explicit in providing that its various carry-forward provisions are inapplicable.

Since, on either basis set forth above, the acquisition and liquidation of Pasadena and of Anaheim were not reorganizations within Section 368 and the carry-forward provisions of Section 381 were inapplicable, it follows that on liquidation Pasadena and Anaheim were properly required to take into income both the amounts of their bad debt reserves previously deducted (*Arcadia Savings and Loan Association* v. *Commissioner*, 300 F.2d 247 (C.A. 9); *Argus, Inc.* v. *Commissioner*, 45 T.C. 63) and amounts earned prior to liquidation but not received. *Idaho First Nat'l. Bank* v. *United States*, 265 F.2d 6 (C.A. 9); *J. Ungar, Inc.* v. *Commissioner*, 244 F.2d 90 (C.A. 2); *First Nat'l. Bank of St. Elmo* v. *United States*, 194 F.2d 389 (C.A. 7).

3. Contrary to petitioner's argument (Pet. 12-21), the decision below does not conflict with *West Side Federal Savings and Loan Assn.* v. *United States*, 494 F.2d 404 (C.A. 6), or *Everett* v. *United States*, 448 F.2d 357 (C.A. 10). In the *West Side* case, a savings and loan association chartered under the laws of Ohio merged into a federal savings and loan association chartered pursuant to 12 U.S.C. 1464. As provided in 12 U.S.C. 1464(b), a federal savings and loan association is a mutual association, without capital stock. Accordingly, the holders of savings accounts in the Ohio association received savings accounts in the federal association of equal withdrawal

value, and the owners of capital stock in the Ohio association received savings accounts in the federal association with a withdrawal value of $2,500 for each share of capital stock in the Ohio association. While we believe that the stockholders of the Ohio association in *West Side* did not have a continuity of interest in the federal association adequate to constitute a reorganization, the court of appeals, in upholding the transaction as a reorganization, pointed out (494 F.2d at 411) that:

> * * * since a savings account is the only proprietary interest available in a federal mutual savings and loan association and the former shareholders of Parma received such accounts in exchange for their stock, it is improper to ignore the proprietary rights included in what they received and concentrate only on their rights as creditors.

Here, however, the situation is quite different. The stockholders of Pasadena and Anaheim received only cash, and no proprietary rights in petitioner, for their stock. The sole proprietary interest in petitioner was, and continued to be, in those who owned, and continued to own, petitioner's guarantee stock both before and after the acquisition of Pasadena and Anaheim.

Everett also involved the acquisition by a federal mutual savings and loan association of the business of a state (Kansas) building and loan association, not by merger but by a transfer of assets for the assumption of liabilities and a relatively small

amount of cash. The holders of full-paid shares and savings shares in the state association received equivalent savings accounts in the federal mutual association, but the $65,000 cash paid was used to retire the permanent shares of the state association. In holding that there was adequate continuity of interest to give rise to a reorganization by virtue of the fact that holders of the full-paid shares and savings shares in the state association had continuing interests in the federal association, the Tenth Circuit was guided by decisions of the Kansas Supreme Court that under Kansas law, savings depositors in Kansas associations had interests as stockholders in those associations. *Ottawa Mut. Loan and Savings Assn.* v. *Merriman*, 67 Kan. 779, 74 Pac. 256; *Independence Savings and Loan Assn.* v. *Sellars*, 149 Kan. 652, 88 P.2d 1059. In this respect, Kansas law differs from California law, as announced by the respective supreme courts of the two states. The differing decisions of the courts of appeals reflecting these differences in the relevant laws of several states are not conflicts requiring resolution by this Court. *Ruhlin* v. *N.Y. Life Ins. Co.*, 304 U.S. 202.

4. For the first time, petitioner relies (Pet. 21-29) upon *Nash* v. *United States*, 398 U.S. 1, as authority in support of its position. *Nash* dealt with the treatment of the bad debt reserve after a transfer of assets to a controlled corporation pursuant to Section 351 of the Code. This case involves no such transaction. Though phrased somewhat differently,

petitioner's argument from *Nash* is little more than a restatement of its argument based upon the assertion that the transactions in question constituted reorganizations. Since they were not reorganizations governed by Section 381, *Nash* has no bearing upon this case.

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

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